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E.O. 12958: DECL: 2/1/2020
TAGS: EFIN ECON EINV PREL LO
SUBJECT: SLOVAKIA READIES CONSTITUTIONAL LAW CAPPING NATIONAL DEBT

REF: 09 BRATISLAVA 425

CLASSIFIED BY: Keith Eddins, Charge d'Affaires, a.i..
REASON: 1.4 (d)

¶1. (C) SUMMARY: The Slovak cabinet is poised to approve a constitutional law capping the public debt at 50% of GDP and reforming government accounting in order to limit the ability of future administrations to "cook the books." The proposals are an effort by Finance Minister Jan Pociatek to box-in the Slovak parliament and force it to confront the country's structural budget deficit following elections in June. A senior Finance Ministry adviser tells us that the ministry has already prepared a set of tax increases that it hopes will be adopted by the next government. END SUMMARY.

¶2. (C) Pociatek announced his proposals on January 27, and an adviser told us that they will be "fast-tracked" and taken directly to cabinet without the typical interministerial review process. The adviser told us that he expects both the cabinet and parliament to approve the proposals quickly, commenting that opposition parties have little choice but to support the legislation since they have strongly criticized the Fico government for its large budget deficit, which rose to 6.3% of GDP in 2009. The proposals include a number of accounting changes in an effort to limit the ability of future governments to disguise the full extent of their budget deficits, including a shift from a three-year non-binding to a four-year binding budget.

¶3. (C) With the public debt having risen dramatically in the last two years--from 27% of GDP before the financial crisis to an expected 41% by the end of 2010--this amendment will leave relatively little room for the next government to maneuver. According to the adviser, this is part of the plan--Pociatek, and presumably Fico, has little confidence in Parliament's willingness to approve difficult spending cuts or tax hikes in the absence of such a hard limit.

¶4. (C) The adviser further told us that the Finance Ministry has already prepared a proposal for closing the structural budget deficit, which he said is about 4% of GDP. Commenting that the state pension plan and healthcare system, which together make up the bulk of the budget, are politically off-limits, he told us that the proposal will instead focus on increasing state revenues. The proposal would dramatically broaden the tax base by moving sole proprietorships (said to number 800,000 in a country with only about 3 million working age citizens) into the social tax system and extending the VAT to books and medicine, which are currently exempted. The VAT would also be raised by a percentage point to 20%.

COMMENT

¶5. (C) Pociatek's tactical approach to the deficit is politically revealing. Until now, Fico has been able to impose slashing cuts on his ministers with barely a whimper of protest, and he is more broadly seen as enjoying a dominant political position. Why, then, would he feel the need to corral Parliament with a constitutional debt ceiling? It could be that he is looking to make cuts in social programs--although doing so would be to cut to the core of his populist "socially responsible" ideology. More likely he is looking for political cover for a higher tax rate and possibly for a more radical restructuring of taxes and tax collection (reftel). Certainly he will need the cover if he intends to go after the popular exemptions for sole proprietorships, which constitute perhaps the biggest--and certainly the most widespread--tax dodge in the country.

EDDINS